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C O N F I D E N T I A L SECTION 01 OF 03 SANAA 002136

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TAGS: [PGOV](#) [ECON](#) [EINV](#) [EPET](#) [ENRG](#) [YM](#)
SUBJECT: YEMEN LNG ON FAST TRACK WITH SUPPORT FROM SALEH;
SOME OBSTACLES REMAIN

REF: A. SANAA 843
[B](#). SANAA 916
[C](#). 2005 SANAA 3185
[D](#). SANAA 1127

Classified By: CDA Nabeel Khoury for reasons 1.4 (b) and (d).

[1](#)1. (C) SUMMARY: In a July 22 meeting with Econoff, Karim Abuhamad of the Yemen Liquid Natural Gas Company (YLNG) said that construction was underway on the LNG pipeline and that the project was back on schedule. The company is close to an agreement with the ROYG on resolving legal ownership of gas reserves in Block 18, part of the fallout from the ROYG's removal of Hunt Oil from the field in late 2005. YLNG still eagerly awaits financing approval from the Overseas Private Investment Corporation (OPIC), and sought information from Post on the status of such a deal. Considerable obstacles also remain in reaching a security agreement for YLNG facilities. Abuhamad praised the work of the state-owned Safir company, which took over for Hunt, and said that it indicated that the ROYG had both the capacity and the will to manage a larger share of production in the future. END SUMMARY.

YLNG Back on Track

[1](#)2. (U) On July 22, Econoff discussed the status of Yemen's LNG project with Karim Abuhamad, Deputy General Manager for YLNG. Abuhamad is on loan to YLNG from Hunt Oil, a 17 percent investor in the company, where he worked since the 1980s. (NOTE: YLNG's other main partners are French Total with 40 percent, the state-owned Yemen Gas Company (YGC) with 17 percent, and SK, Kogas and Hyundai of South Korea for a total of approximately 22 percent. END NOTE.) According to Abuhamad, YLNG is back on schedule after early delays, which General Manager Joel Fort blamed on corruption and a lack of ROYG commitment to the project. (Ref A) Construction has begun on the pipeline that will link gas reserves in Marib to the Balhaf terminal on Yemen's coast, and the first shipments of LNG are expected to leave Yemen at the end of 2008.

[1](#)3. (C) Abuhamad said President Saleh instructed ROYG agencies to fast-track the project, eliminating the internecine struggles and petty corruption that he often encountered in his days with Hunt. To the surprise of many, YGC recently honored its debts to the other investors by selling five percent of its shares to Yemen's General Authority for Social Security and Pensions (GASSP), raising sufficient revenue to cover all commitments for the foreseeable future. "To put it simply," said Abuhamad, "Saleh recognizes the importance of this project for Yemen's future, and isn't about to let anybody screw it up."

Hunt to Give Yemen Gas

14. (C) Abuhamad said that YLNG was still engaged in detailed negotiations with the ROYG regarding control of the gas reserves in Block 18. A 1997 law states that in the event that Hunt can no longer serve as operator in Block 18, control of the gas reserves will transfer to the Marib Services Company (MSC). In the intervening period, Hunt demonstrated considerable foresight in obtaining 30 percent of MSC, and when the state-owned Safir company took control of the Marib field in November 2005, Hunt insisted that the ROYG recognize MSC's right to the gas reserves. (Ref A)

15. (C) Despite its initial hard line, Abuhamad said that Hunt was now considerably more flexible on the matter. He suggested that the two sides would likely reach an agreement in the near future by which MSC would receive some compensation while Safer would be recognized as the long-term provider of gas for the LNG project. Considering the size of the overall enterprise, said Abuhamad, it simply is not in Hunt's interest to hold up progress. Any such agreement would have no effect on the arbitration case currently under consideration in Paris between Hunt and the ROYG regarding the operating rights in Block 18.

U.S. Financing in Doubt?

16. (C) One of the biggest remaining hurdles for YLNG is obtaining the USD 3.7 billion in financing required for the project. Until recently, it was assumed that OPIC would play

SANAA 00002136 002 OF 003

a lead role, securing investment from American banks and serving as a catalyst for other international investors. (Ref B) According to Abuhamad, however, OPIC was always hesitant about the deal, and lately have been expressing concern that YLNG did not settle compensation agreements with landowners and fishermen before beginning the project -- as required by OPIC regulations. Abuhamad insisted that Yemen's weak judicial system made it impossible to settle all claims before beginning work, and said he would not be surprised if this issue were used by OPIC as an excuse to withdraw support.

17. (C) OPIC Senior Investment Officer Mark Sproles told Econoff that a due diligence mission to Yemen had been delayed until September due to the upstream gas dispute, as was ny final decision by the OPIC Board. The loss of PIC support would not ultimately affect the YLNGproject, said Abuhamad, insisting that Total waswilling to bear the full financing burden. Abuhamad was confident that French and Korean banks would fill whatever gaps were left by the United States, but regretted the loss of American (and Hunt) influence in the project that would result.

YLNG Looks For a Bodyguard

18. (C) Other YLNG officials point to the lack of a security agreement with the ROYG. YLNG began negotiations with the Ministry of Interior 14 months ago to sign a memorandum of understanding for sea and land protection. It was the strong preference of YLNG to reach a single agreement with MOI, which also commands the Yemen Coast Guard, and the Central Security Forces (CSF) led by Yahya Saleh, the President's nephew. According to YLNG officials, Yahya delayed signing the contract as part of an attempt to divert funds to Stallion, his private security company staffed with CSF personnel. When YLNG refused to agree, the Ministry of Defense also insisted that it be included in the MOU. The ROYG then insisted that Stallion broker a deal between YLNG and the Ministries of Oil, Interior, and Defense. In the

interim, YLNG hired the 21st Brigade in Shabwa for protection at the Balhaf facility, and is hoping that MOI Alimi will find a way to resolve the impasse.

Safer Exceeds Expectations in Block 18

¶9. (C) In contrast to numerous doomsday predictions made by Hunt executives when their contract expired, Abuhamad reported that the state-owned Safir Company was performing well. (Ref C) Except for the 40 American employees who left the country at the end of Hunt's tenure, Safir has managed to retain all of its expatriate employees, improved their pay and benefits, and is recruiting additional international staff. International employees are making key decisions in managing Block 18, and according to Abuhamad, the result is increased production and exploration. Abuhamad dismissed all claims that increased production was being achieved at the expense of safety standards or by flaring natural gas, although he withheld judgment on the status of long-term maintenance.

¶10. (C) Yemen is no longer exporting any of the oil extracted from Block 18, explained Abuhamad. Instead, the ROYG is sending its crude to the Aden refinery, where it is sold on the domestic market by YGC. Abuhamad said that domestic consumption dramatically reduces the amount of refined oil that Yemen must import, but also raises important questions about the management of oil revenue and possible corruption. Abuhamad claimed that Safer remedied an earlier capital deficit by obtaining permission directly from President Saleh for unlimited withdrawals from the Central Bank of Yemen. These transactions, as well as profits from the YGC domestic oil sales, appear to be off the books. According to Abuhamad, Minister of Oil Khaled Bahah and Prime Minister Abdulkader Bajammal are no longer on speaking terms. The dispute erupted when Bahah advocated for more transparency in managing oil revenues.

State Ownership: The New Trend

¶11. (C) Reflecting on Hunt's experience in Block 18, Abuhamad predicted that the ROYG would never again extend a production sharing agreement (PSA) with an international company. In his view, Safir's operation of Block 18 was a ROYG experiment to see if a state-owned company was capable of taking over a

SANAA 00002136 003 OF 003

major oil reserve in Yemen. Having now passed the test, Abuhamad said he anticipated that Safir would expand into other fields, an intention made clear in an earlier meeting between Bahah and Ambassador. (Ref D) President Saleh sees national ownership as a way to avoid competing interests and damaging corruption scandals, said Abuhamad, and it is popular with Parliament and the public. "Some day, they may even take over YLNG," he laughed.

¶12. (C) COMMENT: The overall assessment of the LNG project is extremely positive, and the remaining legal and financial hurdles seem close to resolution. After wavering at the early stages, the ROYG has now recognized the crucial importance of LNG to Yemen's future, and has given its full support. This support has not extended to the issue of security, however, where top officials continue to delay progress in an attempt to gain the upper hand. On the broader trends in Yemen's oil sector, Abuhamad's endorsement of Safir's management was unusually candid for a Hunt employee, and indicates a growing acceptance of the role of state-owned companies in Yemen's future. With direct control of oil reserves, however, comes an increased opportunity for corruption. It remains to be seen whether the ROYG can translate the Safir's early success, and new profit from LNG, into increased revenue for Yemen and much-needed investment

in its people. END COMMENT.
Khoury